

February 6, 2001

To the Limited Partners:

This correspondence from the General Partner is a summary of the activity of LJM2 Co-Investment, L.P. ("LJM2") during December of 2000, as well as a summary of activity for the year 2000.

### Investment Portfolio

LJM2 closed and funded three new investments during December of 2000 and liquidated two investments. No capital calls were necessary during December, since cash on hand was sufficient to fund the three investments. A summary of these activities, as well as other 4<sup>th</sup> Quarter activities are described below:

Sources (\$millions)	Uses
Cash 10.9	Investments 10.9

### New Investments

Investment	Cost(\$millions)
Ampato	8.0
Max	1.1
Fred	1.8
Total	10.9

### Realized Investments

Investment	Cost(\$millions)	Cash Received	IRR	Cash Multiple
Backbone	30.0	32.4	18%	1.08
GE Turbines	11.3	12.4	36%	1.10
Total	41.3	44.8		

### Current Partnership Summary as of December 31, 2000 (\$millions)

Investments	220.4
Capital Drawn	169.1
Debt Drawn	79.3
Undrawn Partner's Capital	224.9
Amount to be Distributed	29.0

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Investment Portfolio(12/31/00)	Cost (\$millions)
ENA CLO: debt	19.6
ENA CLO: equity	12.9
Resco	0.7
Rawhide	12.5
Raptor 1A	6.0
Raptor 2A	1.1
Margaux	10.0
TNPC	38.0
Osprey I	26.0
Osprey II	6.5
Zenith Telecom	21.0
Raptor III	30.0
First Union CLO	25.2
Ampato	8.0
Max	1.1
Fred	<u>1.8</u>
Total	220.4

### New Investments

On December 11, 2000, LJM2 invested \$1.1 million in **Max, LLC**, which invested in a structured finance vehicle created to monetize Enron's interest in Avici Systems ("Avici"). The purpose of the transaction was to generate funds flow for Enron. Avici develops and sells high speed data networking equipment. Enron owns 1,093,433 shares of Avici, which is a publicly traded security on the NYSE (AVCI). The market price of Avici shares at closing was \$32.375 per share, making the total value of Enron's interest equal to \$35.4 million. The vehicle issues both debt and equity, however the interest payments on the debt are covered by a total return swap from Enron. LJM2 will receive a 15% return on its investment and a return of its capital when either Enron repurchases LJM2's interest in the vehicle before maturity or when the shares are sold at the maturity of the financing in two years. Since the interest on the debt is paid under the total return swap, the stock only needs to increase 1% in value over the two years for LJM2 to receive its return of and return on capital, in the event that Enron does not repurchase LJM2's interest.

On December 11, 2000, LJM2 invested \$1.8 million in **Fred, LLC**, which invested in a structured finance vehicle created to monetize Enron's interest in Catalytica Energy Systems ("Catalytica"). The purpose of the transaction was to generate funds flow for Enron. Catalytica develops proprietary technologies that use catalysts to eliminate the formation of harmful pollutants and improve the performance of hydrocarbon combustion systems. Enron owns 1,339,286 shares of Catalytica, which is a publicly traded security on the NYSE (CESI). The Catalytica shares were not trading at the time of closing, but Enron valued its interest at \$60 million. The vehicle issues both

debt and equity, however the interest payments on the debt are covered by a total return swap from Enron. LJM2 will receive a 15% return on its investment and a return of its capital when either Enron repurchases LJM2's interest in the vehicle before maturity or when the shares are sold at the maturity of the financing in two years. Since the interest on the debt is paid under the total return swap, the stock only needs to increase 1% in value over the two years for LJM2 to receive its return of and return on capital, in the event that Enron does not repurchase LJM2's interest.

On December 20, 2000, LJM2 invested approximately \$8.0 million in **Ampato, LLC** which purchased 20% of the pulp and paper business of Enron. This business operates trading activity in newsprint, packaging, printing and writing, pulp and lumber. The Ampato transaction was structured to deconsolidate the pulp and paper business for Enron. LJM2's equity interest will be repurchased through another financing by June 30, 2001 with a 15% return. If LJM2's equity interest is not purchased by June 30, 2001, the return increases to 30% and LJM2 will receive an additional \$500,000 fee. LJM2 will also have the ability to sell all of the interests in the business, including Enron's, at June 30, 2001, providing significant incentive to Enron to repurchase LJM2's equity interest.

#### **Realized Investments**

On June 30, 2000, LJM2 invested \$30 million in **Backbone, LLC** which purchased 40 fiber optic strands over 86,760 fiber route miles from Enron Broadband Services (EBS). LJM2 also entered into a marketing agreement with EBS that provided for the marketing of the fiber to third parties by EBS on LJM2's behalf. A portion of the fibers was sold on November 22, 2000 and resulted in a payment of \$4.0 million to LJM2. The remainder of the fibers was sold on December 21, 2000 and proceeds of \$28.4 million were realized by LJM2, bringing the total proceeds to \$32.4 million. The realized unlevered annualized return on this investment is 18% with a cash multiple of 1.08 times.

The **GECC Turbine** investment was completed by LJM2 on May 12, 2000. LJM2 purchased two Frame 7EA gas combustion turbines from General Electric and entered into an option agreement with Enron Engineering & Construction Company ("EE&CC") to purchase the turbines in six months. The option period was extended in November for one month until December 15, 2000 at which time an Enron vehicle purchased the turbines at cost for \$11.3 million. LJM2 received an option premium at closing of \$820,078 and additional fees of \$311,252 for the option extension. The realized unlevered annualized return on this investment is 36% with a cash multiple of 1.10 times.

#### **Debt Facilities**

On November 13, 2000, LJM2 closed a new \$120 million, 5 year, credit facility with Dresdner Kleinwort Benson as agent and five other banks. The facility can be increased to a total of \$150 million before May, 2001 if LJM2 needs the capacity. An initial draw of \$79.25 million on the new facility was used to repay outstandings under

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the Chase revolver (\$65 million) and the SE Acquisition Loan (\$14.14 million). Availability under the new facility is currently \$40.75 million.

### **LJM3 Co-Investment, L.P.**

Prior to year-end, Enron approached the General Partner with a request that LJM2 increase its capacity available for year-end Enron deals. Since LJM2 was close to fully invested at the time, it appeared necessary to raise additional capital under a new limited partnership. Therefore, the General Partner solicited commitments for a new partnership, LJM3 Co-Investment L.P. ("LJM3"), to be closed before year-end. Due to the record fourth quarter performance at Enron, the volume of year-end structured deals was not as great as anticipated. In addition, two of LJM2's large investments liquidated in December, providing the partnership with more than enough liquidity to meet Enron's needs. Therefore, although the response to LJM3 was very positive, the General Partner has made the decision to postpone the formation of LJM3 since the amount of Partners' Capital available, plus LJM2's debt capacity at year-end was more than enough to meet year-end liquidity requirements. The need for LJM3 will be reevaluated at mid-year 2001.

### **2000 Portfolio Highlights**

The year 2000 was the first year of operation for LJM2 and proved to be a very active year of investment for the fund. A total of \$451.7 million was invested in 27 different transactions, with \$231.3 million, (10 transactions), either partially or fully divested by year-end. At year-end 2000, \$220.4 million of capital remained invested in 15 investments. The attached Exhibit I shows the investment and liquidation activity in the portfolio on a monthly basis since inception. Exhibit II shows the detail of each investment remaining at December 31, 2000 and Exhibit III shows all of the investments liquidated during the year and the actual unlevered return realized for each investment.

### **Funding for Investments and Partnership Expenses**

The total capital commitment of LJM2 is \$394 million. A total of \$245.9 million of Partners' Capital was drawn during the year as well as \$246.0 million of debt to fund investments and pay partnership expenses. Distributions to the Partners totaled \$99.1 million with \$76.8 million being capital available to be recalled under the terms of the partnership agreement. Unfunded Partners' Capital available at year-end was \$224.9 million in addition to \$40.75 million available under the credit facility and \$28.0 million of recallable capital available for distribution. This brings the total funds available for investments and partnership expenses in 2001 to \$293.65 million. See Exhibits IV and V.

## Portfolio Company Highlights

### TNPC

LJM2 invested \$38 million in The New Power Company ("TNPC") in a second round private placement financing on July 12, 2000 prior to the initial public offering on October 5, 2000. The IPO price was \$21.00 per share, after which the shares have traded as high as \$29.00 per share and as low as \$4.62 per share on November 30, 2000. The share price as of February 5, 2001 was \$10.25 per share. LJM2's cost basis in this investment is \$10.80 per share.

LJM2 is subject to a six month lock up period on the shares before they can be registered. Therefore, we will not be able to register any shares until April 3, 2001. At that time, The General Partner will determine whether to liquidate our position or hold for a longer period based on the market price and the expectations for the business. The General Partner believes the business model for TNPC is strong and prospects for the company are robust.

### First Union CLO

The LJM2 management team met with the First Union CLO manager, IDM, after year-end to discuss the First Union CLO. As of year-end there were no defaults in the portfolio. The IDM research group continues to monitor the portfolio and has identified four assets, which it has placed on its watch list. The IDM team was cautious to add assets that are sensitive to the business cycle and also added telecomm assets that were not fully funded through-out their business plan. Even with the four assets on watch list, the portfolio is still performing well and our investment in the CLO is performing as anticipated.

### Enron CLO

The ENA CLO I Trust ("ENA CLO") has experienced defaults on approximately 29% of its total portfolio of assets. However, Enron provided credit support to the ENA CLO on September 1, 2000, in the form of a put held by the CLO for \$113 million of defaulted assets, which is approximately 33% of the \$340 million of assets in the CLO. As of January 1, 2001, ENA CLO has exercised the put in the amount of \$63.1 million, leaving a total of \$49.9 million available as credit support from Enron. Enron has agreed to amend the put to increase the amount available by approximately \$26.6 million bringing the total available amount to approximately \$76.5 million. Therefore, although the default rate on the portfolio is higher than expected, with the support of Enron, the ENA CLO continues to meet all of the Overcollateralization Tests required on the notes and our investments are not impaired.

### Raptor Vehicles

LJM2 entered into four Raptor vehicle investments during 2000, investing approximately \$30 million in each transaction. Raptors I, II and III were structured with a 6 month put on Enron stock to provide LJM2's return of and return on capital when the put expires. Raptor/TNPC's return of and return on capital was based on the successful IPO of TNPC. Raptor I was completed on May 4, 2000 and was cash settled early on September 7, 2000 for \$40.4 million. Raptor II was completed on July 3, 2000 and cash settled early on October 4, 2000 for \$41.05 million. Raptor III was executed on September 15, 2000 and was cash settled early on January 26, 2001 for \$40.5 million. Raptor/TNPC was completed on September 28, 2000 and cash settled after the IPO of TNPC on October 5, 2000 for \$39.6 million. Therefore, LJM2 has now received its return of and return on capital in all four of the Raptor transactions.

After the cash settlements, LJM2 made an additional investment of \$6.0 million in Raptor I and \$1.1 million in Raptor II. LJM2 will receive a preferred return on these additional investments in addition to the opportunity to receive approximately \$30 million of additional upside on each Raptor transaction at maturity if there is value left in the structure. This value is dependent on Enron stock price, TNPC stock price and the performance of the underlying stocks that are being hedged through the structure.

### **Portfolio IRR**

The projected portfolio IRRs presented at the annual partnership meeting on October 26, 2000 were as follows:

Current portfolio of investments IRR = 51%  
Leveraged IRR to Limited Partners = 69%  
Cash multiple projected = 2.3 X

These numbers have been updated to December 31, 2000 and are as follows:

Current portfolio of investments IRR = 48%  
Leveraged IRR to Limited Partners = 64%  
Cash multiple projected = 2.1 X

The primary difference in the above numbers is the liquidation value of the TNPC investment. The October 26<sup>th</sup> projections assumed that TNPC was liquidated at \$21.00 per share in April 2001, which is \$10.20 per share above the cost basis, equaling a profit of \$36 million. Given the decline in the stock price since the annual meeting, the projections now assume that TNPC is liquidated at the cost basis of \$10.80 per share in April 2001. All of the above projected IRRs assume that Enron stock price increases 15% per year through 2003.

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## Exposure to Enron Stock Price

The portfolio has exposure to Enron stock price, mainly through the Raptor vehicles. The return of and return on capital for all four of the Raptor vehicles has already been realized by LJM2. However, there is the possibility of receiving additional upside at the end of the structures, depending on the performance of Enron stock, TNPC stock and the underlying securities that are being hedged in the Raptor vehicles. The additional amounts have been included in the portfolio return for all of the Raptor vehicles. Enron stock price also affects the upside in the Osprey investments, but has a much smaller effect on the overall portfolio returns. The following illustrates how the portfolio return is affected by changes in Enron stock value only, assuming that all of the Raptor derivatives settle where they are today and that LJM2 receives the upside amount in Raptor/TNPC. The Enron stock price shown below is the price at the maturities of the Raptor vehicles and the Osprey investments in 2003. Enron's stock price as of February 5, 2001 was \$81.81 per share.

Enron Stock Price	<u>\$120</u>	<u>\$90</u>	<u>\$80</u>	<u>\$65</u>	<u>\$51</u>
Leveraged LP IRR	64%	63%	56%	49%	42%
LP Cash Multiple	2.1X	2.0X	1.8X	1.6X	1.5X

## Conclusion

Thanks for all your support during LJM2's first year of operation. This has been a successful year for the fund with deal flow higher than originally expected and projected IRRs far in excess of the targeted 30%. I expect the opportunities for 2001 to be comparable to 2000 in terms of investment opportunities from Enron and profitability of those investments. Please let me know if you have any questions or comments. Thank you again.

Best regards,

Andrew S. Fastow  
General Partner